

**NORTHEAST MICHIGAN COMMUNITY
MENTAL HEALTH AUTHORITY**

Financial Statements For The Year
Ended September 30, 2005

STRALEY, ILSLEY & LAMP P.C.

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended.

Local Government Type <input checked="" type="checkbox"/> City <input type="checkbox"/> Township <input type="checkbox"/> Village <input type="checkbox"/> Other		Local Government Name NE MI COMMUNITY MENTAL HEALTH	County ALPENA
Audit Date 9/30/05	Opinion Date 12/8/05	Date Accountant Report Submitted to State: 2/4/06	

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:

1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.

We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations

You must check the applicable box for each item below.

- ☐ Yes ☒ No 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements.
- ☐ Yes ☒ No 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980).
- ☐ Yes ☒ No 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended).
- ☐ Yes ☒ No 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act.
- ☐ Yes ☒ No 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91], or P.A. 55 of 1982, as amended [MCL 38.1132]).
- ☐ Yes ☒ No 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit.
- ☐ Yes ☒ No 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year).
- ☐ Yes ☒ No 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241).
- ☐ Yes ☒ No 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95).

We have enclosed the following:

	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.	✓		
Reports on individual federal financial assistance programs (program audits).			✓
Single Audit Reports (ASLGU).			✓

Certified Public Accountant (Firm Name) STRALEY, ILSLEY & LAMP P.C.			
Street Address 2106 U.S. 23 SOUTH	City ALPENA	State MI	ZIP 49707
Accountant Signature <i>Straley, Ilsley & Lamp P.C.</i>			Date 2/4/06

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors
**Northeast Michigan Community
Mental Health Authority**
Alpena, Michigan

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the **Northeast Michigan Community Mental Health Authority**, as of and for the year ended September 30, 2005, which collectively comprise the basic financial statements, as listed in the table of contents. These financial statements are the responsibility of the **Northeast Michigan Community Mental Health Authority's** management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the **Northeast Michigan Community Mental Health Authority**, as of September 30, 2005, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis and budgetary comparison information (identified in the table of contents) are not a required part of the basic financial statements but are supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplemental information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the **Northeast Michigan Community Mental Health Authority's** basic financial statements. The other required supplemental information as identified in the table of contents, is presented for additional analysis as is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Straley, Ilsley & Lamp P.C.

December 8, 2005

Northeast Michigan Community Mental Health Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS

Using this Annual Report

This annual report consists of a series of financial statements. The Statement of Net Assets and the Statement of Activities provide information about the activities of the Agency as a whole and present a longer-term view of the Agency's finances. The individual Fund financial statements tell how these services were financed in the short-term, as well as what remains for future spending. Fund financial statements also report the Agency's operations in more detail than the government-wide financial statements.

The Agency as a Whole

The table below shows a comparison of the net assets of the Agency as of September 30, 2005 compared to the prior year.

	Governmental Activities	
	2004-05	2003-04
Current assets	\$ 5,077,195	\$ 5,196,246
Non-current assets	2,257,744	2,294,133
Total assets	7,334,939	7,490,359
Long-term debt outstanding	1,669,641	2,013,189
Other liabilities	1,414,053	1,000,223
Total liabilities	3,083,694	3,113,812
Net Assets		
Invested in capital assets, net of debt	1,162,961	909,812
Restricted Internal Service Funds	451,308	692,172
Unrestricted	2,636,976	2,774,563
Total net assets	\$ 4,251,245	\$ 4,376,547

The current level of unrestricted net assets, the part of net assets that can be used to finance day-to-day operations, is \$2,636,976. This represents about 13.5% of current year expenditures, unchanged when compared to 2003-04. The Agency's net assets decreased 2.9% from a year ago.

Northeast Michigan Community Mental Health Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS

The table below shows a comparison of the change in net assets of the Agency as of September 30, 2005 compared to the prior year.

	Governmental activities	
	2004-05	2003-04
Total program revenues	<u>\$ 19,342,688</u>	<u>\$ 20,384,255</u>
Health and human service expenses		
Mental health services expense	4,617,788	4,757,335
Developmental disability services Expense	11,244,469	12,343,058
Other support services expense	2,389,837	2,054,178
Board administration expense	<u>1,215,896</u>	<u>1,210,479</u>
Total health and human service expenses	<u>19,467,990</u>	<u>20,365,050</u>
Change in net assets	<u>\$ (125,302)</u>	<u>\$ 19,205</u>

Total revenues decreased by 5.1% while total expense decreased by only 4.4% in 2004-05.

General Fund Budgetary Highlights

Over the course of the year, the Agency amended the budget once to take into account events during the year. In prior years, the Agency was able to generate contract savings from its Medicaid and State General Fund contracts. These savings would then be utilized during the following year to provide for increased service demands. During 2004-05, Medicaid expenditures were \$209,173 less than allocated by our Northern Affiliation. The Agency is required to return these unused funds to the Affiliation as required by its contract.

During 2004-05, \$42,084 of 2003-04 General Fund savings was used. In addition, the Agency over utilized its 2004-2005 allocation of General Fund by \$290,416. To cover this over usage, the Agency used \$90,416 of its internal service fund reserved for General Fund risk, and received a one-time transfer of General Funds from the North Country Community Mental Health Board in the amount of \$200,000. During 2004-05, the Agency reclassified approximately \$387,000 of charges for services, previously billed to individuals and individual insurance companies, to General Funds. As a result, charges for services for 2004-05 show negative revenues and General Fund revenues exceed the Agency's annual allocation. Had it not been for this reclassification of charges, our annual allocation of General Funds would have been sufficient to meet 2004-05 service demands.

The Agency was able to hold overall expenditures below planned levels during 2004-05, but not enough to offset the revenue issue noted above. Throughout the year, the Agency implemented many reductions including; the closure of one directly operated home for the developmentally disabled, staff layoffs and hour reductions, and reductions in supply and capital purchases. The Agency also transferred its Local Court, Chore Provider, and Family Subsidy programs to other vendors and individuals due to changes in funding and program requirements for such programs.

Northeast Michigan Community Mental Health Authority

MANAGEMENT'S DISCUSSION AND ANALYSIS

Capital Asset and Debt Administration

As of September 30, 2005, the Agency had \$4,601,356 invested in capital assets, including land, buildings, equipment, furniture, and leasehold improvements. This is an increase of \$27,681 or 0.6% as compared to 2003-04. The total debt related to fixed assets was \$1,094,783. This is a decrease of 21% as compared to 2003-04.

The most significant capital asset purchases during fiscal year 2004-05 were for vehicles and renovations for the relocation of the Assertive Community Treatment (ACT) office. The Agency has a long-term vehicle replacement plan in place to replace high mileage and high maintenance vehicles. The Agency replaced eleven and purchased one new vehicle during fiscal year 2004-05. These assets were purchased using cash from reserved internal service funds set up for asset replacements. In a cost reduction effort, the Agency renovated a portion of the Alpena office to accommodate the ACT team in order to reduce its long-term lease expense. The ACT office is now a stand-alone facility housed at the North end of the Alpena office.

Economic Factors and Next Year's Budgets

The Agency preliminary budget for fiscal year 2005-06 will be approximately \$1,100,000 more than fiscal year 2004-05. This net increase is due primarily to the re-basing of Medicaid managed care capitation rates. It is believed that this increase in Medicaid funding is adequate to serve the needs of the Medicaid population seeking Agency services. The Agency anticipates adding back certain positions and programs that were reduced in 2004-05 when funding decreases occurred. At the same time, state allocated General Funds may decrease during 2005-06. The Agency utilizes General Funds to serve an indigent population that does not qualify for Medicaid insurance. The Agency is seeing increased demand for services from indigent populations. The state is proposing to end its current risk sharing arrangement with the Agency relating to General Fund allocations and spending. Should this occur, the Agency will be required to limit services provided to the indigent population based upon funding, not on service needs. The Agency's General Fund risk reserve is currently \$64,400.

Contacting the Agency's Management

This financial report is intended to provide all readers with a general overview of the Agency's finances and to show the Agency's accountability for the money it receives. If you have questions about this report or need additional information, we welcome you to contact the Finance office.

Northeast Michigan Community Mental Health Authority

STATEMENT OF NET ASSETS

September 30, 2005

	Governmental Activities
ASSETS	
Cash and cash equivalents	\$ 4,346,316
Receivables (net of allowance for uncollectible accounts)	444,304
Prepaid items	286,576
Capital assets (net of accumulated depreciation):	
Land	90,000
Buildings	1,657,537
Building and leasehold improvements	70,596
Vehicles, equipment and furniture	439,610
Total Assets	7,334,939
LIABILITIES	
Accounts payable	1,105,448
Accrued payroll and payroll taxes	305,754
Other liabilities	2,850
Unearned revenue	-
Noncurrent liabilities	
Due within one year	
Compensated absences	93,221
Bonds and notes	238,737
Due in more than one year	
Compensated absences	481,638
Bonds and notes	856,046
Total Liabilities	3,083,694
NET ASSETS	
Investment in capital assets, net of related debt	1,162,961
Restricted for:	
Local match	-
Managed care contract risk	64,611
Asset replacement	386,697
Unrestricted	2,636,976
Total Net Assets	\$ 4,251,245

See accompanying notes to financial statements.

Northeast Michigan Community Mental Health Authority

STATEMENT OF ACTIVITIES

For the Year Ended September 30, 2005

		Program Revenues		Net (Expense) Revenue and Changes in Net Assets
	Expenses	Charges for Services	Operating Grants and Contributions	Governmental Activities
Functions/Programs:				
Health and human services:				
Mental health services:				
Outpatient clinic and case management	\$ 1,875,423	\$ (160,711)	\$ 2,036,134	\$ -
Residential	699,176	(36,590)	735,766	-
Inpatient	934,867	-	934,867	-
Prevention	359,222	(5)	359,227	-
Community support	508,818	8,496	500,322	-
Other	240,282	-	240,282	-
Total mental health services	<u>4,617,788</u>	<u>(188,810)</u>	<u>4,806,598</u>	<u>-</u>
Developmental disability services:				
Residential	6,173,386	-	6,173,386	-
Community support	1,292,992	1,161	1,291,831	-
Supported housing	1,623,564	(12,626)	1,636,190	-
Employment	887,779	-	887,779	-
Clinical support and case management	877,590	592	876,998	-
Other	278,578	9,042	269,536	-
Inpatient	110,580	-	110,580	-
Total developmental disability services	<u>11,244,469</u>	<u>(1,831)</u>	<u>11,246,300</u>	<u>-</u>
Other support services	2,389,837	-	2,389,837	-
Board administration	1,215,896	-	972,316	(243,580)
Total health and human services	<u>19,467,990</u>	<u>(190,641)</u>	<u>19,415,051</u>	<u>(243,580)</u>
General revenues:				
Investment earnings				109,808
Gain (loss) on sale of capital assets				8,470
Total general revenues				<u>118,278</u>
Change in net assets				(125,302)
Net assets - beginning of year				<u>4,376,547</u>
Net assets - end of year				<u>\$ 4,251,245</u>

See accompanying notes to financial statements.

Northeast Michigan Community Mental Health Authority

BALANCE SHEET - GOVERNMENTAL FUNDS

September 30, 2005

	<u>General Fund</u>
ASSETS	
Cash and cash equivalents	\$ 3,320,149
Receivables (net of allowance for uncollectible accounts)	444,304
Prepaid items	<u>286,576</u>
Total Assets	<u><u>4,051,029</u></u>
LIABILITIES AND FUND BALANCES	
Liabilities:	
Accounts payable	1,105,448
Accrued payroll and payroll taxes	305,754
Other liabilities	737
Deferred revenue	<u>2,114</u>
Total Liabilities	<u>1,414,053</u>
Fund Balances:	
Reserved for local match	-
Unreserved	<u>2,636,976</u>
Total Fund Balances	<u><u>2,636,976</u></u>
Total Liabilities and Fund Balances	<u><u>\$ 4,051,029</u></u>

See accompanying notes to financial statements.

Northeast Michigan Community Mental Health Authority

**RECONCILIATION OF THE BALANCE SHEET OF GOVERNMENTAL FUNDS
TO THE STATEMENT OF NET ASSETS**

As of September 30, 2005

Fund balances - Total governmental funds	\$	2,636,976
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Amounts reported for governmental activities in the Statement of
Net Assets are different because:

Capital assets used in governmental activities are not financial
resources and therefore are not reported in the governmental fund.

Governmental capital assets	\$	4,601,356	
Less accumulated depreciation		<u>(2,343,612)</u>	2,257,744

Long-term liabilities are not due and payable in the current period
and therefore are not reported in the governmental fund.

Equipment loans	(149,717)	
Mortgage loans	<u>(945,066)</u>	(1,094,783)

Internal service funds are used by management to charge the
costs of contract risk, leave accruals, and asset depreciation and
replacement to the governmental fund. The assets and liabilities
of the internal service funds are included in governmental activities
in the statement of net assets.

<u>451,308</u>

Net assets of governmental activities	\$	<u><u>4,251,245</u></u>
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See accompanying notes to financial statements.

Northeast Michigan Community Mental Health Authority

**STATEMENT OF REVENUES, EXPENDITURES AND CHANGES
IN FUND BALANCES - GOVERNMENTAL FUNDS**

For the Year Ended September 30, 2005

	<u>General Fund</u>
REVENUES	
State grants	\$ 17,958,438
Contributions from local units	212,869
Charges for services	597,873
Investment interest and rents	76,285
Other revenue	89,229
Total revenues	<u>18,934,694</u>
EXPENDITURES	
Current operations:	
Salaries and benefits	12,172,680
Supplies	417,807
Telephone	97,262
Travel	239,069
Staff development	15,208
Insurance and bonds	178,356
Utilities	152,338
Maintenance	139,462
Rent	303,667
Food	74,969
Bad debts	1,410
Contracted and professional services	4,916,031
Miscellaneous	14,454
Capital outlay	234,618
Debt services:	
Principal retirement	289,518
Interest and fees	57,456
Total Expenditures	<u>19,304,305</u>
EXCESS REVENUE OVER (UNDER) EXPENDITURES	<u>(369,611)</u>
OTHER FINANCING SOURCES (USES)	
Proceeds from long term debt	-
Operating transfers from other funds	(306,882)
Operating transfers to other funds	538,906
Total other financing sources (uses)	<u>232,024</u>
REVENUES AND OTHER SOURCES OVER (UNDER) EXPENDITURES AND OTHER USES	(137,588)
FUND BALANCES, beginning of the year	<u>2,774,563</u>
FUND BALANCES, end of the year	<u>\$ 2,636,976</u>

See accompanying notes to financial statements.

Northeast Michigan Community Mental Health Authority

**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES - GOVERNMENTAL FUNDS
TO THE STATEMENT OF ACTIVITIES**

For the Year Ended September 30, 2005

Net change in fund balances - Total governmental funds	\$	(137,587)
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Amounts reported for governmental activities in the Statement of Activities are different because:

Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is depreciated over their estimated useful lives.

Expenditures for capital assets	\$	234,618	
Less current year depreciation		<u>(270,987)</u>	(36,369)

Proceeds from debt are used by management to finance capital asset purchases. Proceeds from debt are not reported as financing sources on the statement of activities.

Proceeds of debt	-
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Repayment of bank and other loan principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of activities.

Debt principal payments	289,518
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Internal service funds are used by management to charge the costs of certain activities to individual funds. The net revenue (expense) of the internal service funds is reported with governmental activities.

<u>(240,865)</u>

Change in Net Assets of Governmental Activities	\$	<u><u>(125,302)</u></u>
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See accompanying notes to financial statements.

Northeast Michigan Community Mental Health Authority

STATEMENT OF NET ASSETS - PROPRIETARY FUNDS

September 30, 2005

	Governmental Activities - Internal Service Funds
ASSETS	
Cash and cash equivalents	<u>\$ 1,026,167</u>
Total Assets	<u>1,026,167</u>
LIABILITIES	
Noncurrent liabilities	
Due within one year	
Compensated absences	93,221
Due in more than one year	
Compensated absences	<u>481,638</u>
Total Liabilities	<u>574,859</u>
NET ASSETS	
Investment in capital assets, net of related debt	-
Restricted for:	
Managed care contract risk	64,610
Asset replacement	386,698
Unrestricted	<u>-</u>
Total Net Assets	<u><u>\$ 451,308</u></u>

See accompanying notes to financial statements.

Northeast Michigan Community Mental Health Authority

**STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET FUND ASSETS -
PROPRIETARY FUNDS**

For the Year Ended September 30, 2005

	Governmental Activities - Internal Service Funds
OPERATING REVENUES	
Charges for services	\$ -
Total operating revenues	-
OPERATING EXPENSES	
Salaries and benefits	38,791
Capital outlay	-
Total operating expenses	38,791
OPERATING INCOME (LOSS)	(38,791)
NONOPERATING REVENUES (EXPENSES)	
Investment income	33,522
Total nonoperating revenues (expenses)	33,522
Net income (loss) before transfers	(5,269)
TRANSFERS	
Operating transfers to general fund	(258,423)
Operating transfers from general fund	22,828
Change in net assets	(240,864)
Net Assets , beginning of the year	692,172
Net Assets , end of the year	\$ 451,308

See accompanying notes to financial statements.

Northeast Michigan Community Mental Health Authority

STATEMENT OF CASH FLOWS - PROPRIETARY FUNDS

For the Year Ended September 30, 2005

	<u>Internal Service Funds</u>
CASH FLOWS FROM OPERATING ACTIVITIES	
Leave payouts to employees	\$ (93,220)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
Operating transfers in	22,828
Operating transfers out	(258,423)
CASH FLOWS FROM INVESTING ACTIVITIES	
Interest earnings	<u>33,522</u>
Net increase (decrease) in cash and cash equivalents	(295,293)
CASH AND CASH EQUIVALENTS - beginning of year	<u>1,321,460</u>
CASH AND CASH EQUIVALENTS - end of year	<u><u>\$ 1,026,167</u></u>
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES:	
Operating Income (loss)	\$ (38,791)
Increase (decrease) in accrued expenses	(54,429)
Net cash provided (used) by operating activities	<u><u>\$ (93,220)</u></u>

See accompanying notes to financial statements.

Northeast Michigan Community Mental Health Authority

NOTES TO FINANCIAL STATEMENTS

NOTE 1--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES.

The accounting policies of the Northeast Michigan Community Mental Health Authority (NEMCMHA) conform to generally accepted accounting principles (GAAP) as applicable to governmental units. The following is a summary of the significant accounting policies used by the NEMCMHA:

A. Reporting Entity.

Description of Operations. NEMCMHA is a multi-county authority serving Alcona, Alpena, Montmorency and Presque Isle Counties located in northeastern Michigan of the lower peninsula.

NEMCMHA provides community services to the mentally ill and the developmentally disabled through inpatient treatment, day programs, residential services, case management out-patient treatment, and prevention. Direct services are provided to approximately 2,302 persons at any point in time within the four county region. Services are offered through the clinic center, satellite offices, and through its many residential settings.

NEMCMHA operates under a Board of Directors (12 members), who establish policy and review operations.

B. Government-Wide and Fund Financial Statements

During the year ended September 30, 2004, the NEMCMHA implemented a new financial reporting model, as required by the provisions of GASB Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*. The new standard requires government-wide and fund financial statements.

The government-wide financial statements (i.e., the statement of net assets and the statement of changes in net assets) report information on all of the nonfiduciary activities of the primary government and its component units. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, normally supported by taxes and intergovernmental revenues, are reported separately from business-type activities which rely to a significant extent on fees and charges for support. Likewise, the primary government is reported separately from certain legally separate component units for which the primary government is financially accountable.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segments are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include: (1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment; and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenue.

Separate financial statements are provided for governmental funds, proprietary funds and fiduciary funds, even though the latter are excluded from the government-wide financial statements.

C. Measurement Focus, Basis of Accounting and Financial Statement Presentation

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary fund and fiduciary fund financial statements. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Northeast Michigan Community Mental Health Authority

NOTES TO FINANCIAL STATEMENTS

NOTE 1--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES. (continued)

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenue is recognized as soon as it is both measurable and available. Revenue is considered to be available if it is collected within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, expenditures relating to compensated absences, and claims and judgments are recorded only when payment is due.

State-shared revenue, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenue of the current fiscal period. All other revenue items are considered to be available only when cash is received by the government.

The government reports the following major governmental funds:

General Fund. This fund (also known as the CMH or Agency Fund) includes the financial transactions of the NEMCMHA not properly accounted for in another fund. The revenues of this fund are derived primarily from state, other intergovernmental sources, and charges for services.

Additionally, the government reports the following fund types:

Internal Service Fund. These funds are used to account for 1) major machinery and equipment purchases, 2) compensated leave liability, and 3) contract risk funds for state contract.

Agency Fund. This fund is used to account for assets held in trust or as an agent for others.

Private-sector standards of accounting issued prior to December 1, 1989, are generally followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with the standards of the Governmental Accounting Standards Board. The government has elected not to follow private-sector standards issued after November 30, 1989 for its business-type activities.

As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements.

Cash and Cash Equivalents. Cash and cash equivalents consist of checking and savings accounts, certificates of deposit, and other highly liquid short-term investments with a maturity date within three months of the date acquired by the NEMCMHA.

Accounts Receivable. Patient accounts receivable are recorded at the gross amount billed with an allowance for any uncollectible amounts.

Inventories and Prepaid Items. Inventories are valued at cost, on a first-in, first-out basis. Inventories of governmental funds are recorded as expenditures when consumed rather than when purchased. Certain payments to vendors reflect costs applicable to future fiscal years and are recorded as prepaid items in both government-wide and fund financial statements.

Northeast Michigan Community Mental Health Authority

NOTES TO FINANCIAL STATEMENTS

NOTE 1--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES. (continued)

Capital Assets. Capital assets, which include vehicles, equipment, furniture, buildings, and leasehold improvements, are reported in governmental activities in the government-wide financial statements. Capital assets are defined by the agency as assets with an initial individual cost of more than \$200 and an estimated useful life in excess of one year. Such assets are recorded at historical cost. Personal property assets costing less than \$5,000 are fully depreciated on the day of purchase as allowed by federal OMB Circular A-87 (as revised).

Property, plant and equipment are depreciated using the straight-line method over the following useful lives:

Buildings 40 years
Building Improvements 15 years
Leasehold improvements 15 years
Office Equipment 7 years
Vehicles 5 years
Computer Equipment 5 years

Long-Term Obligations. In the government-wide financial statements and the proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities.

Compensated Absences. Reflects the accrual of compensated absences adjusted to current salary costs. Permanent employees earn annual leave based upon full or part-time status proportionate to the time worked. Annual leave is vested at this point and may be accrued to a total of 360 hours. A small number of employees have accrued leave hours above 360 according to the terms of the policy when it was revised in April 2000. Upon termination, employees are paid a percentage of their unused leave, depending upon the number of hours accumulated and their employment classification.

Revenues. Effective October 1, 1998 NEMCMHA converted to a managed care revenue system. Under this system capitated managed care revenues are received from the Michigan Department of Community Health. These contracted amounts are based upon the number of covered lives (patients) who qualify for Medicaid funding in the four counties served. When capitated revenue is received in advance it is recorded as a deferred revenue and then recorded as earned revenue when services are delivered to patients. Any monies unspent under 95% of the contract amount must be returned to the state. Any monies NEMCMHA spends over 100% of the contract amount are shared on a pro-rata basis. Fee for service revenues are recorded when services are delivered to patients not covered under the managed care contract.

Use of Estimates. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities; disclosure of contingent assets and liabilities at the date of the financial statements; and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimated.

NOTE 2--COMMUNITY MENTAL HEALTH AUTHORITY.

Effective October 1, 1998, NEMCMHA switched from a Community Mental Health Agency to a Community Mental Health Authority. As a result of the change, NEMCMHA is a public governmental entity separate from the counties that established it.

Northeast Michigan Community Mental Health Authority

NOTES TO FINANCIAL STATEMENTS

NOTE 3--STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY.

Budgets and Budgetary Accounting. Prior to adoption of the operating budget of the NEMCMHA, management prepares and submits their proposed operating budget for the fiscal year commencing the following October 1. A public hearing is conducted to obtain interested-party comments. The budget is then adopted by the NEMCMHA Board.

The budget is to be prepared, or sufficient supplemental records maintained to permit a presentation of the budget, on the same basis of accounting as the financial statements. NEMCMHA prepares its budget by cost centers and program categories to facilitate reporting to the Michigan Department of Community Health. The budgetary comparison schedule for NEMCMHA is presented on a line item basis.

Individual budget amendments were not material in relation to the original appropriations.

Excess of expenditures over appropriations in budgeted funds. The Uniform Budgeting and Accounting Act, PA 2 of 1968, as amended, (MCL 141.421 et seq.), provides that a local governmental unit shall not incur expenditures in excess of the amount appropriated. The NEMCMHA'S actual expenditures and budgeted expenditures for the funds budgeted have been shown on a line item basis.

Accumulated Fund Deficits. NEMCMHA had no funds with an accumulated fund balance deficit at September 30, 2005.

NOTE 4--CASH AND INVESTMENTS.

Statutes authorize the NEMCMHA to invest as follows:

- (a) In bonds, securities, and other obligations of the United States, or an agency or instrumentality of the United States in which the principal and interest is fully guaranteed by the United States.
- (b) In certificates of deposit, savings accounts, deposit accounts, or depository receipts of a bank or a savings and loan association which is a member of the federal deposit insurance corporation or a credit union which is insured by the national credit union administration, but only if the bank, savings and loan association, or credit union is an eligible Michigan depository.
- (c) In commercial paper rated at the time of purchase within the 3 highest classifications established by not less than 2 standard rating services and which matures not more than 270 days after the date of purchase. No more than 50% of any fund may be invested in commercial paper at any time.
- (d) In United States government or federal agency obligation repurchase agreements.
- (e) In bankers' acceptances of United States banks.
- (f) In mutual funds composed of investment vehicles which are legal for direct investment by local units of government in Michigan.

For the year ended September 30, 2005, the carrying amount of deposits was \$4,346,316 (excluding consumer trust funds held in the consumer name of \$83,171) and the bank balance was \$4,565,073. Of the bank balance \$200,000 was covered by Federal Depository Insurance (FDIC), with the remaining balance of \$4,365,073 being uninsured.

Northeast Michigan Community Mental Health Authority

NOTES TO FINANCIAL STATEMENTS

NOTE 5--CAPITAL ASSETS.

Capital asset activity for the current year was as follows:

	Balances 10/1/2004	Additions	Reductions	Balances 9/30/2005
Governmental Activities				
Capital assets not being depreciated				
Land	\$ 90,000	\$ -	\$ -	\$ 90,000
Subtotal	90,000	-	-	90,000
Capital assets being depreciated				
Vehicles	964,975	158,114	193,638	929,451
Computer equipment	1,116,909	14,778	-	1,131,686
Furniture	151,801	500	3,256	149,045
Other Equipment	188,415	11,206	5,697	193,924
Buildings	1,859,535	-	-	1,859,535
Building improvements	134,545	12,198	2,790	143,953
Leasehold improvements	51,136	9,833	1,556	59,414
Client equipment	16,359	27,989	-	44,348
Subtotal	4,483,675	234,618	206,937	4,511,356
Less accumulated depreciation for				
Vehicles	594,069	142,698	193,638	543,130
Computer equipment	1,095,363	20,573	-	1,115,937
Furniture	151,801	500	3,256	149,045
Other Equipment	182,657	12,152	5,697	189,112
Buildings	140,389	61,609	-	201,997
Building improvements	57,504	20,550	2,790	75,264
Leasehold improvements	48,797	10,265	1,556	57,507
Client equipment	8,981	2,641	-	11,621
Subtotal	2,279,561	270,988	206,937	2,343,613
Net capital assets being depreciated	2,204,113	(36,370)	-	2,167,743
Governmental activities capital total				
Capital assets, net of depreciation	\$ 2,294,113	\$ (36,370)	\$ -	\$ 2,257,743

Northeast Michigan Community Mental Health Authority

NOTES TO FINANCIAL STATEMENTS

NOTE 6--LONG-TERM DEBT (including current portions). Long-Term Debt of NEMCMHA is as follows:

	Balances 9/30/2004	Additions	Reductions	Balances 9/30/2005
Governmental Funds				
Notes payable, vehicles, dated 3/12/01 - 4/24/01, with interest rate of 5.25%, maturing 3/12/05 - 4/24/05	\$ 23,919	\$ -	\$ 23,919	\$ -
Notes payable, vehicles, dated 4/2/02 - 5/23/02, with interest rate of 3.69%, maturing 3/12/06 - 5/23/06	55,689	-	34,061	21,628
Notes payable, vehicles, dated 3/31/03 - 4/30/03, with interest rate of 2.30%, maturing 3/30/06 - 4/30/06	94,744	-	58,603	36,141
Notes payable, computer equipment, dated 5/2/03, with interest rate of 2.5%, maturing 5/1/07.	42,700	-	15,662	27,038
Notes payable, vehicles, dated 4/27/04, with interest rate of 2.80%, maturing 4/27/07.	104,456	-	39,547	64,909
Notes payable, building, dated 12/29/00, with interest rate of 5.34%, maturing 12/29/10.	130,386	-	18,044	112,342
Notes payable, mortgage, dated 6/15/02, with interest rate of 4.66%, maturing 6/15/12.	814,731	-	89,137	725,594
Notes payable, building, dated 6/19/03, with interest rate of 6%, maturing 6/19/13.	117,675	-	10,544	107,131
Total governmental funds	<u>1,384,300</u>	<u>-</u>	<u>289,517</u>	<u>1,094,783</u>
Internal Service Funds				
Accrued compensated absences, net	<u>629,288</u>	<u>38,791</u>	<u>93,221</u>	<u>574,859</u>
Total long-term debt all funds	<u>\$ 2,013,589</u>	<u>\$ 38,791</u>	<u>\$ 382,738</u>	<u>\$ 1,669,642</u>

Northeast Michigan Community Mental Health Authority

NOTES TO FINANCIAL STATEMENTS

NOTE 6--LONG-TERM DEBT (including current portions). (continued)

The annual requirements to pay principal and interest on governmental fund notes outstanding at September 30, 2005 are as follows:

September 30	Total	Interest	Principal
2006	\$ 284,583	\$ 45,846	\$ 38,737
2007	203,249	37,604	165,645
2008	167,711	30,754	136,957
2009	167,711	23,905	143,806
2010	167,711	16,710	151,001
2011-2015	271,472	12,836	258,636
Total	<u>\$ 1,262,437</u>	<u>\$ 167,655</u>	<u>\$ 1,094,782</u>

NOTE 7--LEASES.

NEMCMHA is party to numerous operating leases, for which aggregate rental expense was approximately \$303,667 and \$372,403 in 2005 and 2004, respectively. These leases are chiefly for residential property and office facilities used to shelter and serve the needs of consumers.

The following is a schedule of future minimum lease payments required under the operating leases that have initial or remaining terms as of September 30, 2005:

September 30	
2006	\$ 144,229
2007	99,264
2008	97,153
2009	85,508
2010	74,325
2011 - 2012	77,988

NOTE 8--RETIREMENT.

NEMCMHA has adopted a defined contribution retirement plan covering all full-time employees who have completed 2 1/2 years of service and are at least 20 1/2 years of age at June 1. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings. Individual contracts, which are maintained by the plan trustees, are purchased for each eligible participant by the employer. Contributions up to 7.5% of the employees prior year's annual pay is paid entirely by the employer. Benefits are fully vested with the employees when the contribution is made. The NEMCMHA's total payroll in the year ended September 30, 2005 and 2004 was \$8,969,241 and \$9,536,439, respectively. Pension contributions were calculated using the base salary amount of \$5,866,926 and \$6,638,232 at June 1, 2005 and 2004, the plan anniversary date.

NOTE 9--POST EMPLOYMENT BENEFITS.

NEMCMHA provides no post employment benefits to employees.

Northeast Michigan Community Mental Health Authority

NOTES TO FINANCIAL STATEMENT

NOTE 10--RISK MANAGEMENT.

NEMCMHA participated in the public entity risk pool - Michigan Municipal Risk Management Authority (Authority) for auto and general liability, property and crime and vehicle physical damage coverage.

The Authority, a separate legal entity, is a self-insured association organized under the laws of the State of Michigan to provide self-insurance protection against loss and risk management services to various Michigan governmental entities.

As a member of the pool, the board is responsible for paying all losses, including damages, loss adjustment expenses and defense costs, for each occurrence that falls within the member's self-insurance retention. If a covered loss exceeds the Authority's limits, all further payments for such loss are the sole obligation of the board. If, for any reason, the Authority's resources available to pay losses are depleted, the payment of all unpaid losses of the Board is the sole obligation of the Board.

The Authority's coverage limits are \$1,000,000-\$5,800,000 for personal property, \$15,000,000 for liability, \$100,000 for judicial tenure defense, and \$1,500,000 for vehicle physical damage.

NOTE 11--CONTINGENCIES AND CLAIMS.

In the normal course of business, NEMCMHA submits an annual spending plan to its major funding source, the Michigan Department of Community Health. Throughout the year draws are received by NEMCMHA based on the spending plan. Subsequently, a cost settlement of actual allowable expenditures is determined. Until the final cost settlement, certain amounts previously advanced are subject to disallowance and may be required to be repaid. Any potential disallowed costs are unknown at this time and cannot be reasonably estimated. These adjustments may be material to the financial statements.

Northeast Michigan Community Mental Health Authority

**STATEMENT OF REVENUES, EXPENDITURES AND FUND BALANCES
BUDGET AND ACTUAL - GOVERNMENTAL FUNDS**

For the year ended September 30, 2005

	Budget Amounts		Actual	Variance with
	Original	Amended	Amounts	Final Budget Favorable (Unfavorable)
Budgetary Fund Balance, October 1	\$ 2,774,563	\$ 2,774,563	\$ 2,774,563	\$ -
Resources (Inflows):				
State grants	18,467,491	18,089,459	17,958,438	(131,021)
Contributions from local units	212,869	212,869	212,869	(0)
Charges for services	1,373,941	875,065	597,873	(277,192)
Investment interest and rents	36,710	45,000	76,285	31,285
Other revenue	53,239	73,241	89,229	15,988
Proceed from long-term debt	-	-	-	-
Operating transfers from other funds	-	793,063	538,907	(254,156)
Amounts available for appropriation	22,918,813	22,863,260	22,248,164	(615,096)
Charges to appropriation (outflows):				
Salaries and benefits	13,191,031	12,317,973	12,172,682	145,291
Supplies	387,393	450,185	417,807	32,378
Telephone	122,705	118,006	97,262	20,744
Travel	253,515	245,852	239,069	6,783
Staff development	37,289	27,085	15,208	11,877
Insurance and bonds	171,537	177,229	178,356	(1,127)
Utilities	158,978	145,904	152,338	(6,434)
Maintenance	165,986	192,350	139,462	52,888
Rent	373,674	304,954	303,667	1,287
Food	88,454	81,218	74,969	6,249
Bad debts	-	-	1,410	(1,410)
Contracted and professional services	4,795,065	4,895,175	4,916,031	(20,856)
Miscellaneous	9,450	9,714	14,454	(4,740)
Capital Outlay	79,942	296,983	234,618	62,365
Debt Services	326,231	347,672	346,974	698
Operating transfers to other funds	-	192,005	306,882	(114,877)
Total charges to appropriations	20,161,250	19,802,305	19,611,189	191,116
Budgetary fund balance, September 30	\$ 2,757,563	\$ 3,060,955	\$ 2,636,975	\$ (423,980)

Northeast Michigan Community Mental Health Authority

BALANCE SHEET - AGENCY FUNDS

September 30, 2005

	<u>Consumer Trust Funds</u>
ASSETS	
Cash and cash equivalents	<u>\$ 83,171</u>
Total assets	<u><u>\$ 83,171</u></u>
LIABILITIES AND FUND EQUITIES	
Deposits Held	\$ 83,171
Fund balance	<u>-</u>
Total liabilities and fund balance	<u><u>\$ 83,171</u></u>

Northeast Michigan Community Mental Health Authority

STATEMENT OF CHANGES IN ASSETS AND LIABILITIES - TRUST FUNDS

September 30, 2005

	Balances, Sept. 30, 2004	Additions	Deletions	Balances, Sept. 30, 2005
CONSUMER TRUST FUNDS				
ASSETS				
Cash	\$ 78,692	\$ 901,972	\$ 897,493	\$ 83,171
Total assets	<u>\$ 78,692</u>	<u>\$ 901,972</u>	<u>\$ 897,493</u>	<u>\$ 83,171</u>
LIABILITIES AND EQUITIES				
Deposits held	\$ 78,692	\$ 901,972	\$ 897,493	\$ 83,171
Total liabilities	<u>\$ 78,692</u>	<u>\$ 901,972</u>	<u>\$ 897,493</u>	<u>\$ 83,171</u>

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January 30, 2006

To the Board of Directors
Northeast Michigan Community Mental Health
Authority (NEMCMHA)
Alpena, Michigan

We have audited the financial statements of the Northeast Michigan Community Mental Health Authority (NEMCMHA) for the year ended September 30, 2005, and have issued our report thereon dated December 8, 2005. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility Under U.S. Generally Accepted Auditing Standards

As stated in our engagement letter dated October 31, 2005, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance about whether the financial statements are free of material misstatement and are fairly presented in accordance with U.S. generally accepted accounting principles. Because an audit is designed to provide reasonable, but not absolute, assurance and because we did not perform a detailed examination of all transactions, there is a risk that material errors, fraud, or other illegal acts may exist and not be detected by us.

As part of our audit, we considered the NEMCMHA's internal control. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

Significant Accounting Policies

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by NEMCMHA are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year ending September 30, 2004. We noted no transactions entered into by NEMCMHA during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

Accounting Estimates

Accounting estimates are an integral part of the basic financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. Management's estimate of the useful lives of fixed assets for depreciation purposes is based on historical information and industry estimates. We evaluated the assumptions used to develop depreciation expense in determining that it is reasonable in relation to the basic financial statements taken as a whole.

Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the governmental unit's financial reporting process (that is, cause future financial statements to be materially misstated). In our judgment, none of the adjustments we proposed, whether recorded or unrecorded by NEMCMHA, either individually or in the aggregate, indicate matters that could have a significant effect on NEMCMHA's financial reporting process.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's basic financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Issues Discussed Prior to Retention of Independent Auditors

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the NEMCMHA's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Reportable Conditions

Reportable conditions involve matters coming to our attention, under standards established by the American Institute of Certified Public Accountants, relating to significant deficiencies in the design or operations of the internal control structure that, in our judgment, could adversely affect the ability to record, process, summarize, and report financial data consistent with the assertions of management in the basic of financial statements. We discovered no reportable conditions that should be reported to management. Our consideration of the internal control structure would not necessarily disclose all matters that might be reportable conditions.

Other Matters

Recent Pronouncements. The Governmental Accounting Standards Board and Michigan Department of Mental Health, in its continuing process of updating the accounting principles that all governments must adhere to, has issued the following recent pronouncements that will have an impact on the way the NEMCMHAS maintains its financial records:

GASB Statement No. 45 Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans. This Statement establishes uniform financial reporting standards other postemployment benefit plans. The provisions of this Statement are effective for fiscal periods beginning after December 15, 2007.

We with to thank the staff of the NEMCMHA for their assistance during the audit.

This report is intended solely for the information and use of the Northeast Michigan Community Mental Health Authority (NEMCMHA) Board of Directors, Michigan Department of Mental Health, Management, and others within the governmental unit and is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit the distribution of this report, which upon acceptance by NEMCMHAS, is a matter of public record.

We appreciate the opportunity to serve NEMCMHA. If you have any questions, or if we can be of further service, please do not hesitate to contact us.

Straley, Ilsley & Lamp P.C.